Government-Sponsored Perversity


Norman Myers and Jennifer Kent have written a comprehensive and engaging book about one of the biggest impediments to environmental quality and sustainability—perverse subsidies. The book does a splendid job of documenting and quantifying perverse subsidies in six main sectors globally. One thing it lacks, however, is a really concise definition of perverse subsidies.

Here is what is meant: A subsidy is a payment by a government to an individual or firm, the intent of which, theoretically, is to decrease the divergence between private and social costs and benefits—to internalize externalities. (An externality is a cost or benefit that is not paid for—i.e., it is external to the market. Private costs and benefits are usually internal, and social costs and benefits are usually external to the market.) A perverse subsidy is therefore a payment by a government to an individual or firm that, instead, increases the divergence between private and social costs and benefits. These subsidies can be direct or indirect.

Direct subsidies are direct government payments to agriculture, fossil fuel and nuclear energy, road construction, water, fisheries, and forestry (the six major sectors documented in Myers’s book). Some of these subsidies are, of course, not perverse. They serve the intended purpose of reducing the divergence between private and social costs and benefits. But a large proportion of current direct subsidies are perverse. Myers and Kent estimate that globally 60 percent of conventional subsidies are perverse. This amounts to $860 billion annually.

Indirect subsidies are the failure of government to internalize externalities (especially environmental externalities)—leaving an unaddressed divergence between private and social costs and benefits. All indirect subsidies are (by definition) perverse, and Myers and Kent estimate their total at $1,090 billion annually.

The total direct and indirect perverse subsidies worldwide are therefore estimated to be almost $2 trillion annually. As Myers and Kent point out, this is almost three times global military spending, larger than the annual sales of the 20 largest corporations, and four times the annual incomes of the 1.3 billion poorest people on earth. In other words, perverse subsidies are a huge problem, but an inherently solvable one, the elimination of which would yield a double dividend: It would first help to reduce the divergence between private and social costs and benefits, thus making the economy function more efficiently, and second, it would free up funds to help solve other pressing problems.

All of the perverse subsidies documented by Myers and Kent have either direct or indirect connections to environmental concerns. The largest category of perverse subsidies, according to Myers and Kent’s estimates, is road transportation, at $780 billion per year. Road construction directly destroys habitat (2 percent of total land area in the United States is covered by roads) and burning fossil fuels in cars causes a significant portion of total air pollution, including global warming—causing CO2. The next largest category of perverse subsidy is agriculture, at $510 billion per year. Agricultural subsidies lead to overuse of herbicides and pesticides and excessive soil erosion, among many other environmental problems. The next largest category is fossil fuels and nuclear energy, at $300 billion per year. These subsidies lead to overconsumption of energy, air and water pollution, and the failure to develop renewable alternatives. Likewise, perverse subsidies to water ($230 billion per year), fisheries ($25 billion per year), and forestry ($92 billion per year) can be shown to be the causes of a host of significant environmental problems.

Critics will, of course, argue that these estimates are far too uncertain and “mushy” to have any meaning. Myers and Kent acknowledge the huge difficulties, but point out that as long as the issue of perverse subsidies remains untackled, there tends to be an implicit presumption that their total must effectively be zero: There is the asymmetry of evaluation at distortional work. Of course, this is not what is intended. But as long as a problem is not accorded adequate attention, it is implicitly viewed as if it is not a problem at all.

Myers and Kent “resist the temptation to say we simply cannot appraise perverse subsidies in quantified fashion at all” (p. 21). Instead, they take on the challenge and ask the reader to accept the well-documented qualifications that must always accompany any difficult analysis such as this one. They also point out that their estimates are almost certainly conservative—further analysis and better data would reveal even larger numbers.

Why do perverse subsidies persist? The answer is obvious, given the way our political systems work. One example is enough to demonstrate the magnitude and recalcitrance of the problem. Between 1993 and mid-1996, the American oil and gas industry gave $10.3 million to political campaigns and received $4 billion in tax breaks (Drew 1999). This represents a benefit–cost ratio of about 400 to 1. Few investments in our economy are anywhere near as lucrative as this! Given these kinds of returns, it is little wonder that perverse subsidies exist and that they